

# State Capitalism and the Chinese Firm: Legal and Policy Issues

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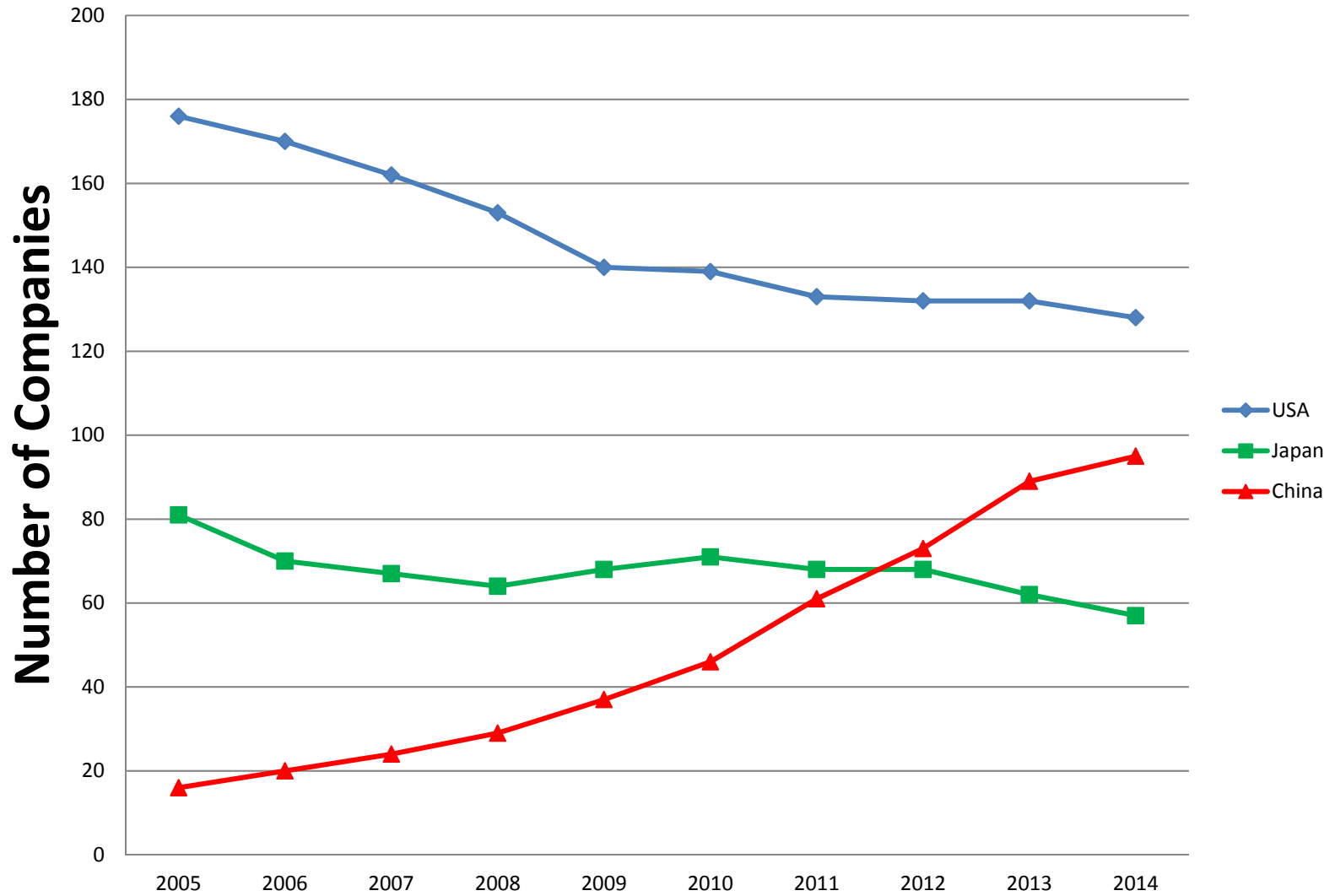
*Lin & Milhaupt, Stanford Law Review (2013)*

*Milhaupt & Zheng, Georgetown Law Journal (2015)*

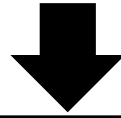
*Milhaupt, in Cambridge Univ. Press (forthcoming 2016)*

# Fortune Global 500

2005-2014



Family: Capitalism



Genus: Corporate Capitalism



Species:

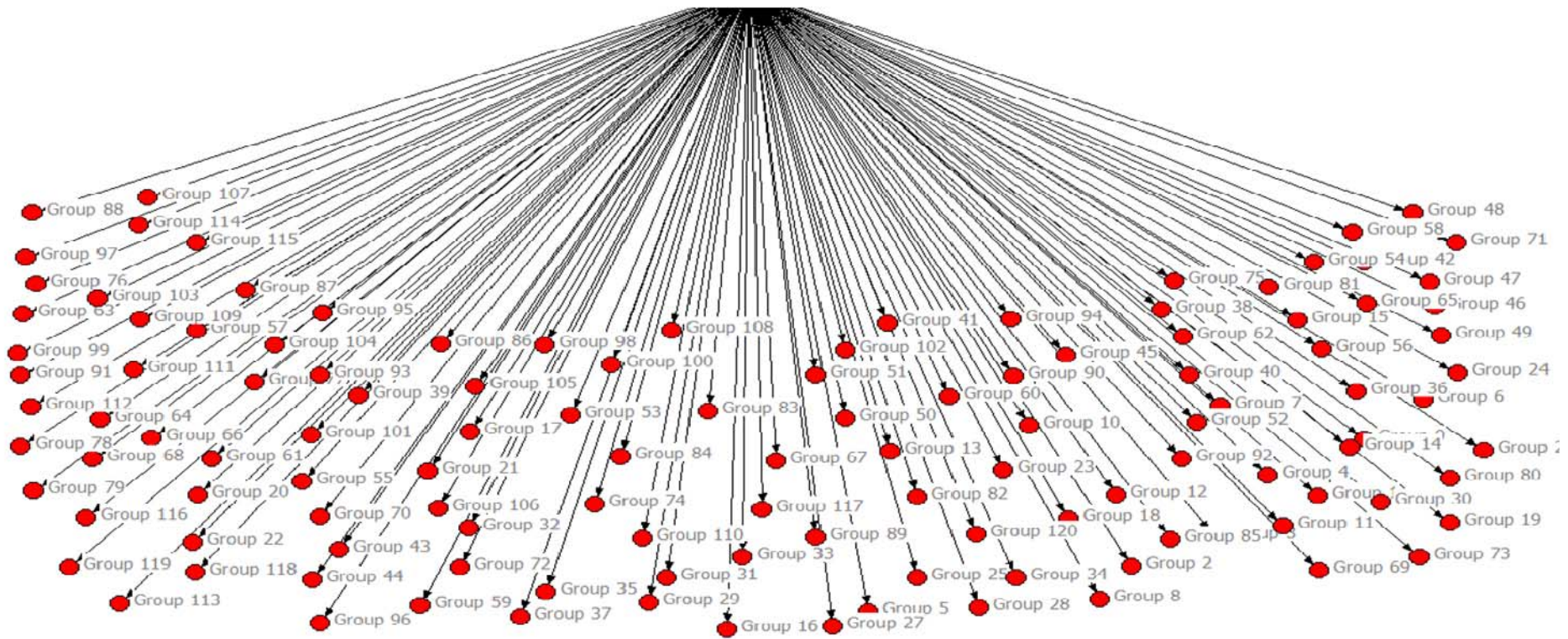
Shareholder-Oriented  
(LME)

Stakeholder-Oriented  
(CME)

State  
(SOE)

# World's Largest Controlling Shareholder

SASAC



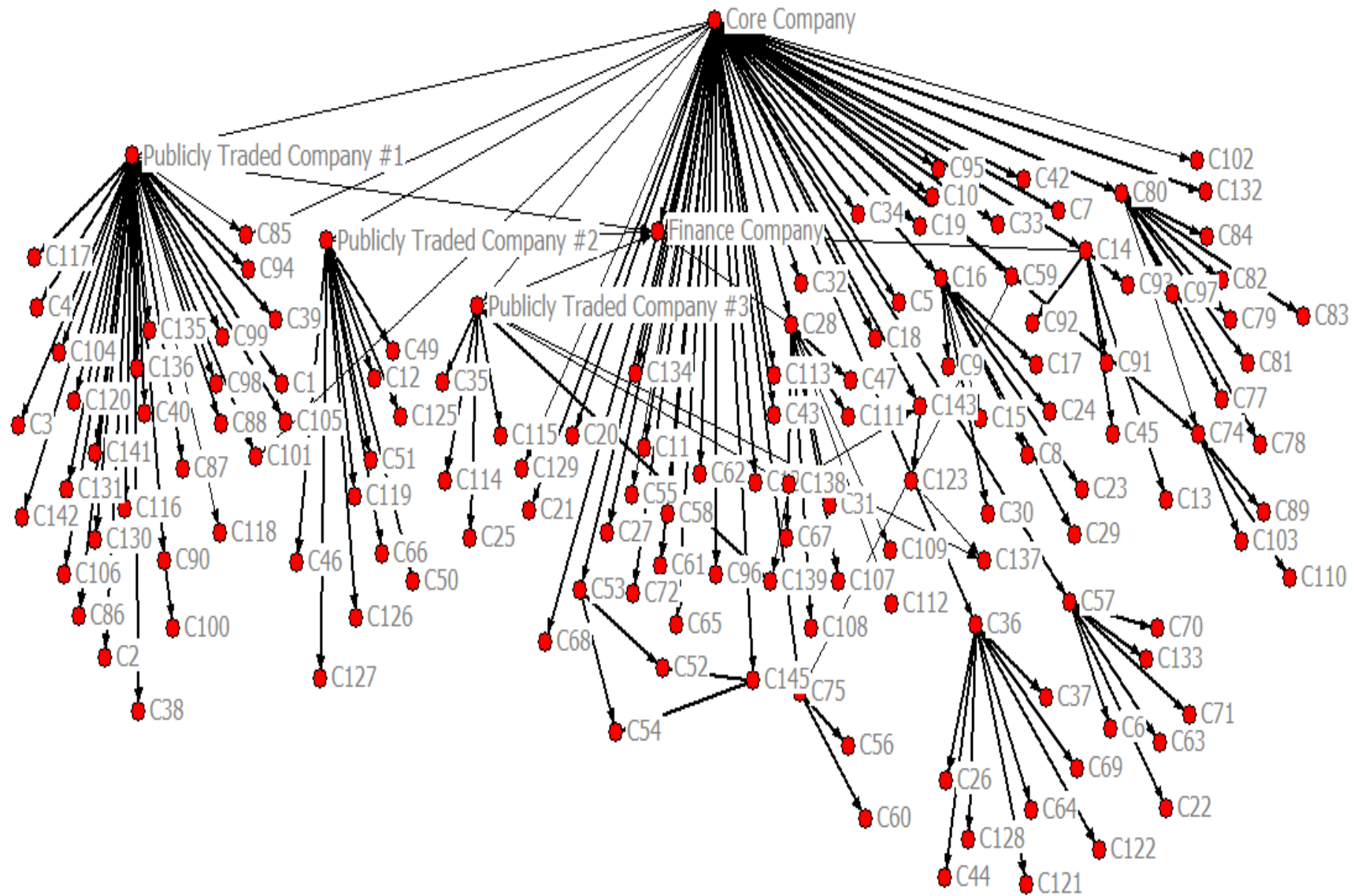
Total Assets of SOEs in China : \$6 trillion (133% of GDP), 2008

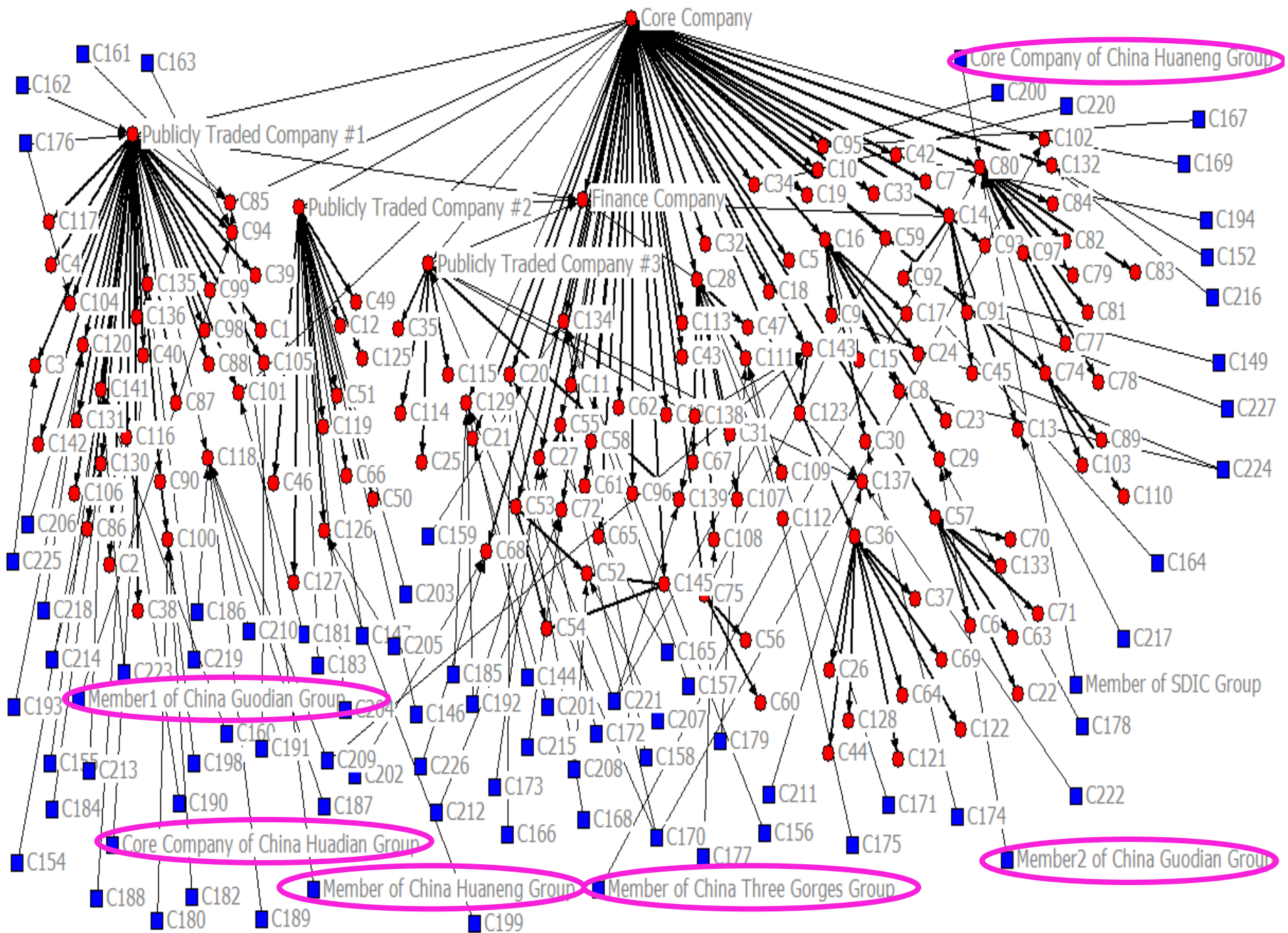
Total Assets of SOEs in France: \$686 billion (28% of GDP), 2008

# China Datang

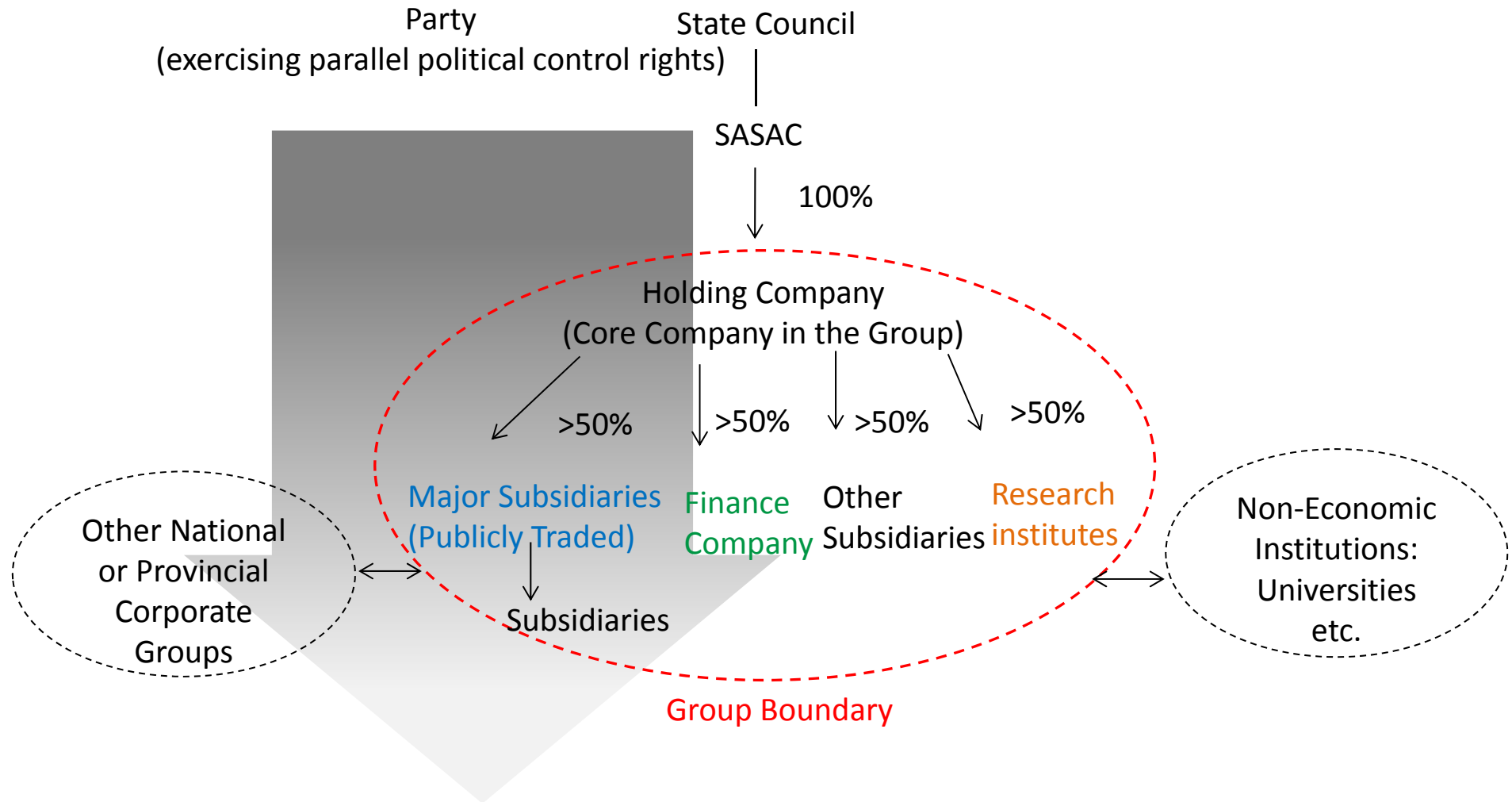
392 on Global Fortune 500; \$30b revenues





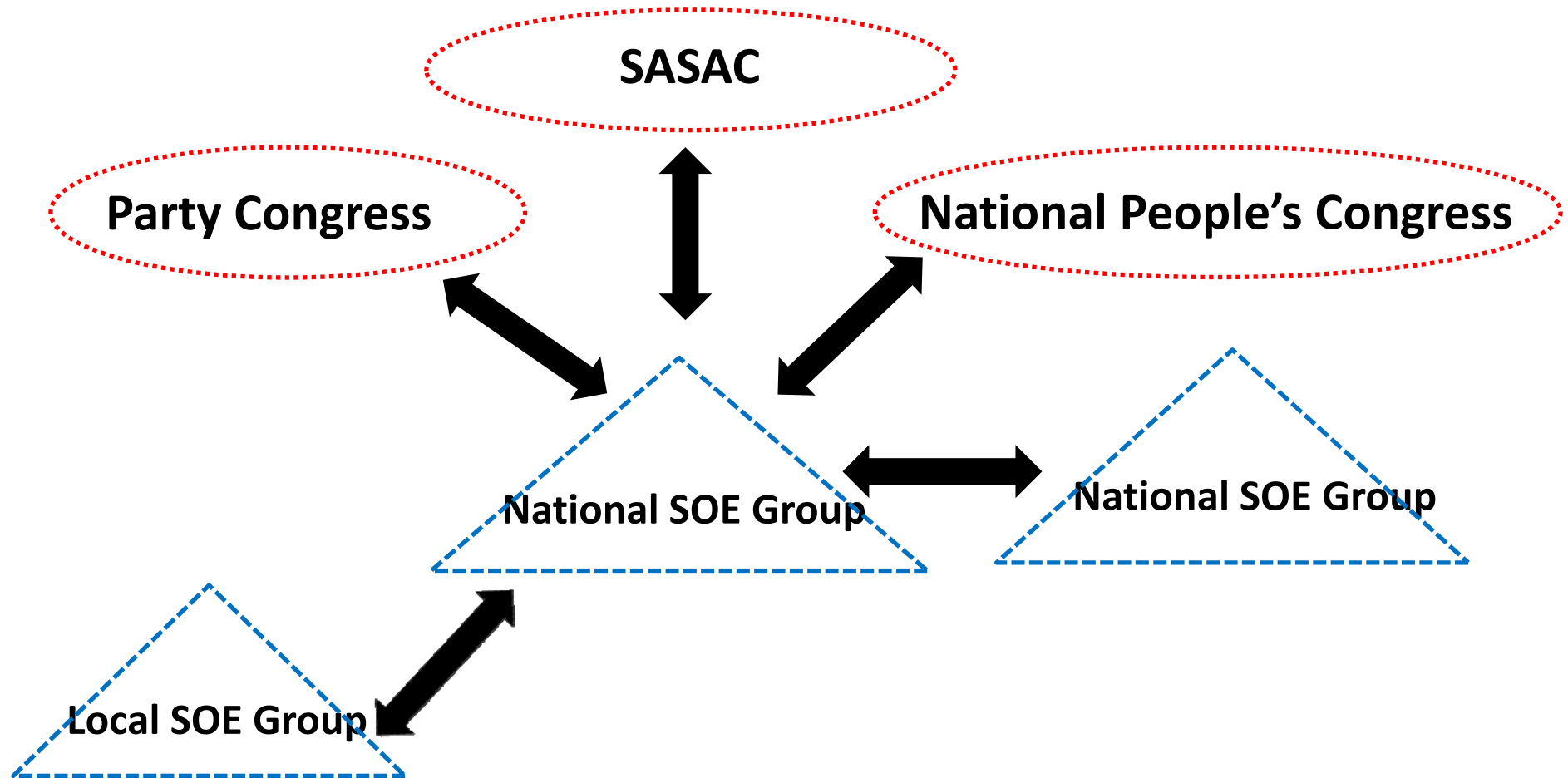


# Central SOE Structure





# China's Networked State Capitalism

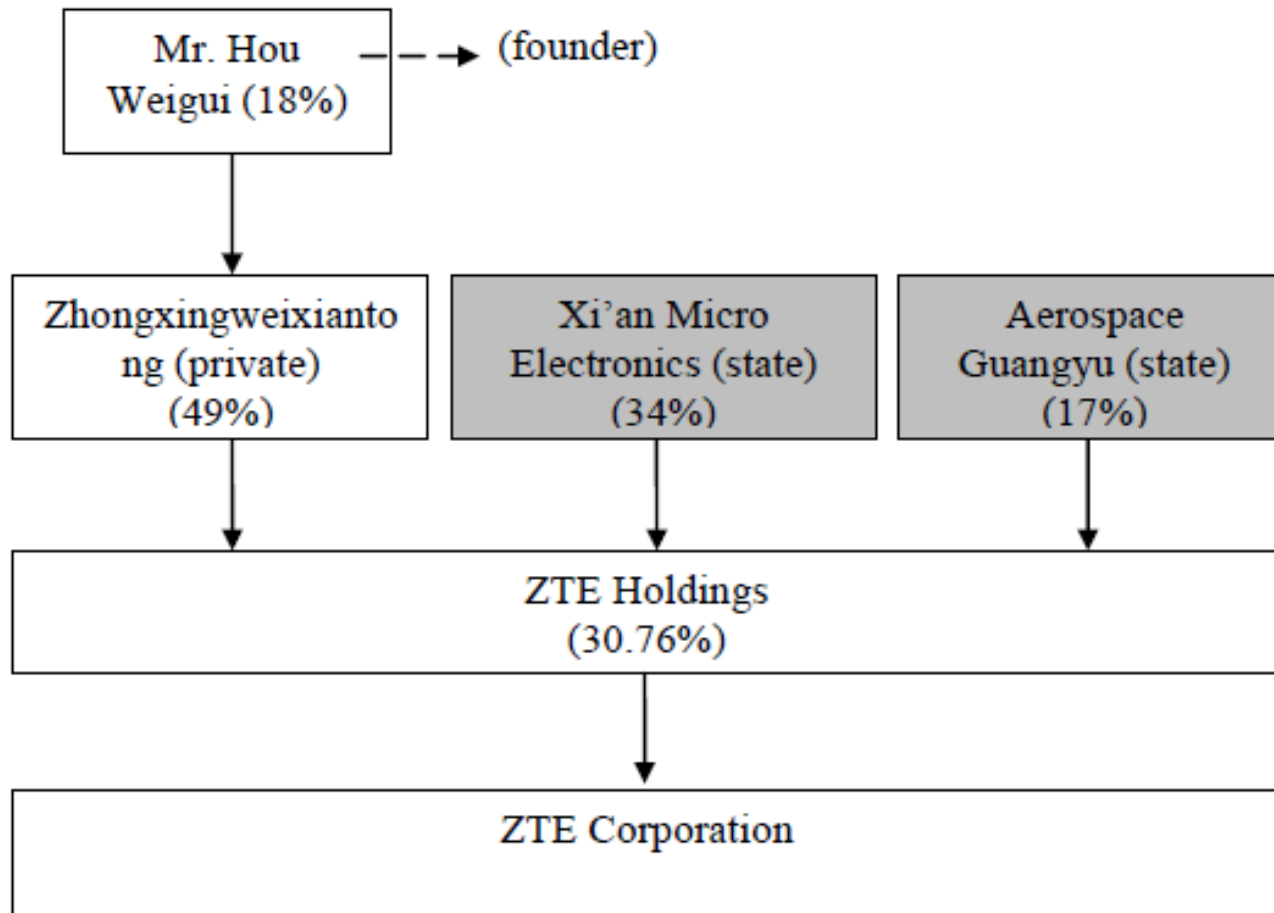


# “SOEs” v. “Private Firms”

- Ownership does not tell us much about large Chinese firms:
  - Boundary between “SOE” and “POE” is often blurred in China.
  - The state exercises less control over SOEs than commonly assumed
  - The state exercises more control over POEs than commonly assumed.
- Chinese state capitalism is better explained by capture of the state than by ownership of enterprise

# Mixed Ownership

Figure 1. Ownership Structure of ZTE Corporation



# Attenuated State Control Over SOEs

- Agency theory: state ownership  $\neq$  state control (potential versus actual control)
- Low dividends paid by SOEs to government
- Large amounts of unregulated executive compensation at SOEs
- Government seldom acts in its capacity as controlling shareholder to modify SOE behavior

# **Extensive State Control Over/Relationship with POEs**

- Politically connected entrepreneurs have extensive linkages to government-party organs just like SOE executives
- Extensive government support for (favored) private firms
- Extra-legal control over private firms

# Politically Connected Entrepreneurs

Firm Rank	Firm	Founder or De Facto Controller	Party-State Affiliations, as of 2013
1	Suning Electronics Group	ZHANG Jindong	CPPCC
2	Lenovo Holdings Ltd. Co.	LIU Chuanzhi	CPC; NPC; CNAIC Vice Chairman
3	Huawei Investment Holdings Ltd. Co.	REN Zhengfei	None*
4	Jiangsu Sha Steel Group Ltd Co.	SHEN Wenrong	NPC; CPC
5	Shandong Weiqiao Group Ltd. Co.	ZHANG Shiping	NPC; Shandong People's Congress
6	Zhejiang Geely Holdings Group Ltd. Co.	LI Shufu	CPPCC; Taizhou City People's Congress
7	Dalian Wanda Group Ltd. Co.	WANG Jianlin	CPC; CPPCC Standing Committee; CNAIC Vice Chairman
8	Yurun Holdings Group Ltd. Co.	ZHU Yicai	NPC; CNAIC Standing Committee
9	Wanke Enterprises Ltd. Co.	WANG Shi	China Real Estate Association; Shenzhen Chamber of Commerce
10	Meidi Group Ltd. Co.	HE Xiangjian	Shunde District People's Congress; Foshan City PPCC

# State Subsidies to POEs

	Subsidy, US\$ m	Subsidy to Net profit, %	Rank in 2010	Rank in 2009
1. Geely Automobile	141.0	51.3	1	3
2. China Yurun Food	84.0	36.1	2	2
3. Uni-President	9.1	18.2	na	na
4. Sihuan Pharmaceutical	18.6	14.5	4	na
5. WuXi PharmaTech	9.9	12.2	5	5
6. Want Want China	47.4	11.3	6	6
7. Hengan International	35.5	10.3	na	na
8. Gome	26.7	9.2	9	na
9. China Shanshui Cement	28.2	7.6	3	4
10. China Gas Holdings	7.3	7.2	na	1

*Source:* company statements, Fathom China research

# Legal and Policy Implications

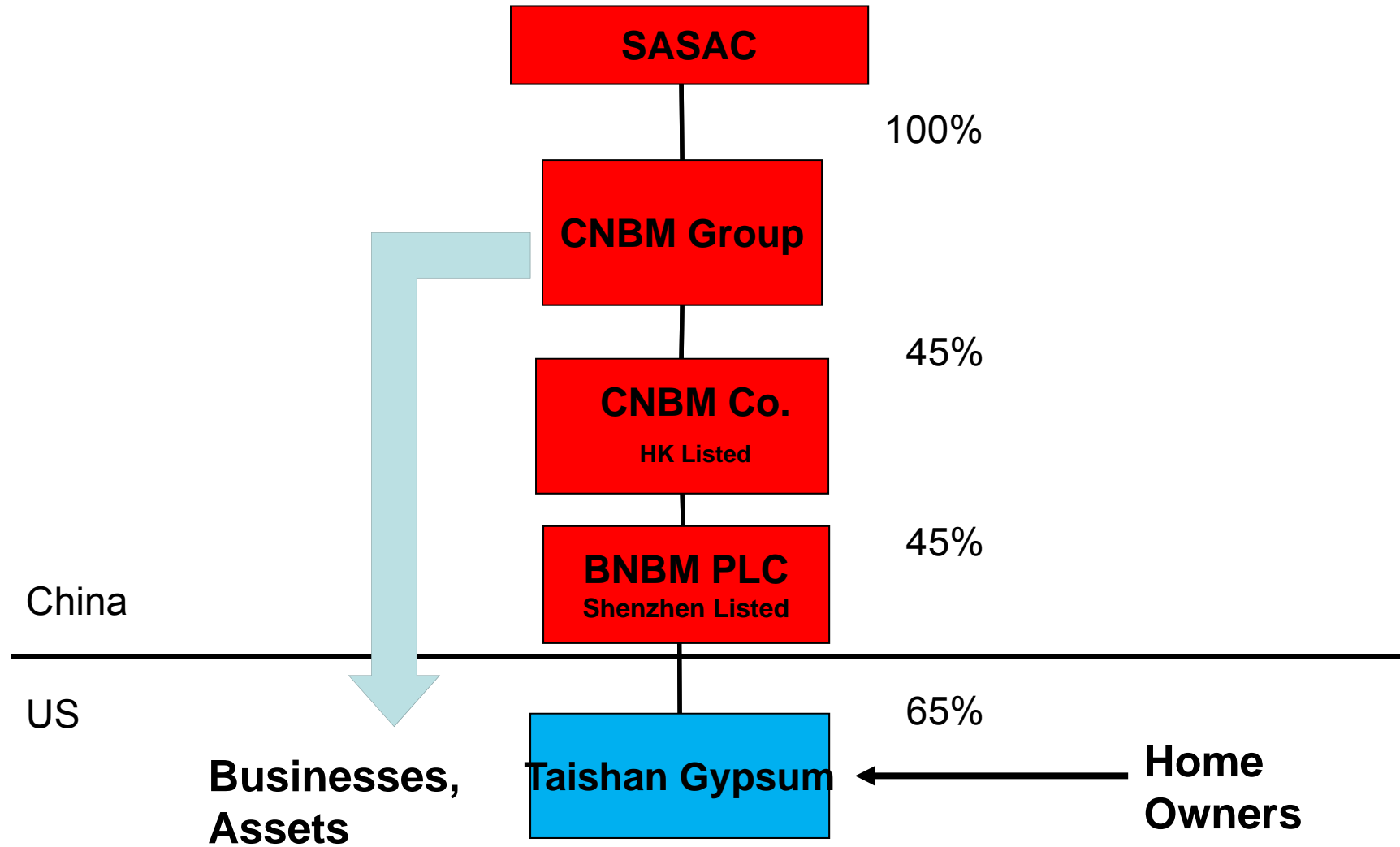
- For Chinese State Sector Reform
- For U.S. Law
  - Personal Jurisdiction and Liability
  - Antitrust
  - National Security Screening for FDI



# China's "Mixed-Ownership Reforms"

- Inject more private capital into SOEs to enhance competitiveness and improve management
- But retain (and strengthen) party-state control over "strategic" and "pillar" industries
- Our analysis suggests ownership-based reforms miss the mark
- Reforming institutional environment for corporate behavior is key

# Litigation in US Courts



# Antitrust

- Sovereign Compulsion Defense
  - Vitamin C: Alleged price fixing
  - Bauxite: Alleged conspiracy to limit supply
- Merger Analysis (cf European Commission)

# National Security Screening

- Committee on Foreign Investment in the United States (CFIUS)
  - Members include heads of Treasury, Homeland Security, State, Commerce, Defense, etc.
  - Inter-agency review (30 days)
  - Can trigger 45-day investigation
  - Automatic 45-day investigation for “foreign government controlled transactions”
  - Can initiate negotiations on mitigation agreement
  - If CFIUS still has national security concerns after investigation, it can recommend that president exercise authority to block transaction

# Covered Transactions by Home Country

- Home country for largest number of covered transactions in years 2012-14: China (UK or Japan second)
- China was home country of 20% of all covered transactions in years 2012-14 (compare UK: 12.5%)

# CFIUS in Action

- 2008-2014: 627 notices filed with CFIUS
- 39% resulted in an investigation
- 3% withdrawn during review stage
- 8% withdrawn during investigation stage
- President made 1 decision to block a transaction (Ralls Corporation (owned by Chinese nationals who are officers of Chinese POE) acquisition of wind farms near air space restricted by U.S. Navy)
- *Ralls* (D.C. Cir. 2014): Fifth Amendment due process violation

# Illustration of “Suspicion Tax” on Chinese Firms

- Chongqing Casin Enterprise Group to acquire Chicago Stock Exchange (Feb. 2016)
  - CCEG was formed out of formerly state-owned assets
  - Active in areas Chinese government considers sensitive
  - Chairman is member of industry group led by Mayor of Chongqing
- “The American market has little information about CCEG, and it shares many of the traditional opaque qualities of a Chinese company... Should you determine CCEG maintains a close relationship with the Chinese government – and therefore the Chinese military – we would urge CFIUS to deny this transaction.”

Letter from 45 Republican Senators to Treasury Department

# Conclusion

- State capitalism is dead; long live state capitalism!
- Large, globally active Chinese firms (SOE and POE) present novel legal and policy issues for a range legal regimes
- Where will change occur: Chinese firms or legal regimes?